

Construction contractors incur Retailers' Occupation Tax liability when they engage in selling of tangible personal property to purchasers without permanently affixing the tangible personal property to real estate. See 86 Ill. Adm. Code 130.1940. (This is a GIL).

November 9, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated August 3, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

Would you please provide us with a private letter ruling regarding the sales and use tax ramifications of following issues.

Questions pertaining to use tax mean, for materials purchased in Illinois, should we pay sales tax when the materials are purchased. Questions pertaining to sales tax are whether or not we should charge sales tax to our customers.

Outline of the business:

1. Sell and install walk-in refrigeration units that are affixed to real estate.
2. Occasionally sell stand-alone refrigeration units that are not affixed to real estate.
3. Sell service contracts to maintain such equipment. The typical contract provides for labor, consumables, parts and refrigerant. On the average less than 35% of the contract value is for materials.
4. Provide service and maintenance of walk-in and stand-alone refrigeration units. This includes labor, consumables, parts and refrigerant. Parts and refrigerant are billed separately and the cost is marked up. On the average less than 35% of the total invoice is for materials.
5. During the course of a year the average of the cost of refrigerant, consumables and parts is less than 35% of the sales of service and parts.

Questions:

a. Are the sales of the walk-in units subject to sales or use tax?

Please find enclosed copies of 86 Ill. Adm. Code 130.1940 and 130.2075 regarding the tax liabilities of contractors in Illinois. The term "construction contractors" includes general contractors, subcontractors, and specialized contractors such as landscape contractors. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. Construction contractors incur Use Tax and local Retailers' Occupation Tax reimbursement liabilities, payable to their suppliers, based upon their cost price of items which they purchase for subsequent incorporation into real estate. See the enclosed copy of 86 Ill. Adm. Code 130.2075. If construction contractors pay their suppliers the appropriate Use Tax and local Retailers' Occupation Tax rate for their suppliers' location, then construction contractors incur no further liability. If such materials are purchased without paying tax, such as from unregistered out-of-State suppliers, the purchasing contractors must self-assess and pay the Use Tax directly to the Department.

When billing construction contract jobs, contractors are prohibited from charging their customers an amount designated as "tax" because the construction contractors bear the legal incidence of the tax. The legal incidence does not fall upon the customers because the customers are not buying tangible personal property from contractors when they enter into contracts for improvements to real estate. Contractors may, however, contract for customers to reimburse them for an amount equal to the tax.

b. Are the sales of stand-alone units subject to sales or use tax?

Construction contractors incur Retailers' Occupation Tax liability when they engage in selling any kind of tangible personal property to purchasers without permanently affixing the tangible personal property to real estate (these types of sales are sometimes referred to as "over-the-counter" sales). See 86 Ill. Adm. Code 130.1940(b)(1). Please note that construction contractors can purchase such tangible personal property tax-free for resale by providing their suppliers with Certificates of Resale. See the enclosed copy of 86 Ill. Adm. Code 130.1405.

c. Are the consumables, refrigerant and parts that are used to perform the service subject to sales or use tax? Is there a difference between service contracts on walk-in units and stand-alone units?

The taxability of service contracts or maintenance agreements depends upon if the charges for those agreements are included in the selling prices of the tangible personal property. If such charges are included in the selling price, those charges are part of the gross receipts of the retail transactions and are

subject to tax. If this is the case, no tax is incurred on the maintenance services or parts when the repairs or servicing is performed.

Alternatively, persons may sell service contracts or maintenance agreements as separate agreements for predetermined fees. In these transactions, the proceeds from the sale of such contracts or agreements are not subject to tax. However, servicemen who provide service under the separate maintenance agreements or service contracts incur Use Tax liability based on their cost price of the tangible personal property transferred incident to the completion of the maintenance agreements. See the enclosed copy of 86 Ill. Adm. Code 140.301(3)(b). Further, the purchaser of the separate agreement or warranty is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement. If a deductible is charged to the purchaser under the terms of the separate agreement, the deductible is also not subject to tax.

If repairs are made which are not covered by or are outside of the terms and conditions of a maintenance agreement, repairmen making such repairs would generally be considered servicemen. If machinery permanently affixed to real estate is repaired, the servicemen are considered construction contractors and owe Use Tax on items that they transfer as described in the answer to question (b) above. However, in regards to repairing machinery that is not permanently affixed to real estate, please note that Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods

provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

Please note that servicemen who also make over-the-counter sales are required to be registered under Section 2a of the Retailers' Occupation Tax Act. This means that such servicemen are not able to utilize the unregistered de minimis option described in the preceding paragraph. Such servicemen incur Service Occupation Tax and provide their suppliers with Certificates of Resale. See the enclosed copy of 86 Ill. Adm. Code 130.1405.

- d. Occasionally we perform a repair where a major component is replaced and the cost of materials exceeds 35% of the total charge. Is the cost of the major component a separate item from the other materials? Is it subject to sales or use tax?**

As noted above in the answer to question (c), the cost of materials exceeding 35% is not a factor when repairs are made to equipment that is incorporated into real estate. However, the cost of materials exceeding 35% for repairs to equipment that is not incorporated into real estate may be a factor depending upon which tax base the serviceman chooses as described above in the answer to question (c). Please note that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. This determination must be made on an annual aggregate basis for the serviceman's fiscal year. See subsection (f)(2) of the enclosed copy of 86 Ill. Adm. Code 140.101

- e. Occasionally the refrigerant is more than 35% of the cost of the service call, is the cost of the refrigerant subject to sales or use tax?

See the answer to question (d) above.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.